



## Sustainability Leaders Strategy



**Benedict Buckley CFA**  
Managing Director,  
Portfolio Manager



**Dimitry Dayen CFA**  
Managing Director,  
Portfolio Manager



**Mary Jane McQuillen**  
Head of ESG,  
Portfolio Manager

### Key Takeaways

- ▶ Equities fell broadly as AI capex concerns, software disruption fears, private credit stress and Middle East energy shocks pushed investors toward defensives and cyclicals tied to real assets.
- ▶ The Strategy outperformed on stock selection, despite no energy exposure, helped by strength in health care, real estate and industrials.
- ▶ We remain overweight industrials, materials and semiconductors, targeting beneficiaries of data center/electricity buildout and reshoring, balanced by underweights to areas with higher AI disruption risk and macro sensitivity.

### Market Overview

Most major equity indexes declined in the first quarter as concerns over rising AI capex at hyperscalers, inklings of AI disruption in software, stress in private credit and a shock to energy prices from the war in the Middle East outweighed a nascent rally for cyclical stocks. The Russell 3000 Index fell 4.0%, with a rotation in leadership dragging the information technology (IT) sector down 9.1% while the energy sector rallied 38.4%.

Materials, utilities, consumer staples, industrials and real estate outperformed: defensive sectors were favored by investors amid uncertainty stemming from the Middle East conflict, whose disruptions to commodity supply chains helped materials. Industrials, meanwhile, held on to some of their gains from the cyclical rally in January and February, which was driven by improving ISM and by demand for AI infrastructure. Financials and consumer discretionary lagged due to concerns over accelerating redemptions in private credit funds and potential macroeconomic weakness following the spike in energy prices, respectively.

### Performance Overview

Against this backdrop, the ClearBridge Sustainability Leaders Strategy outperformed its benchmark Russell 3000 Index despite the significant headwind in the quarter of not owning traditional energy (the Strategy explicitly excludes oil and gas).

Relative outperformance was driven by strong stock selection in health care, real estate and industrials. In health care, idiosyncratic growth characteristics have become even more valuable as macro uncertainty has increased. Our top contributor there was Johnson & Johnson, a relatively low-multiple stock seeing an acceleration in earnings as it

moves past a loss of exclusivity on a major drug franchise. In real estate, Equinix (a data center REIT) benefited from an improvement in demand partially stemming from growing AI adoption by enterprises.

In IT, while semiconductor equipment maker ASML posted significant gains on accelerating demand for manufacturing equipment for memory and logic chips and was a top contributor, software stocks sold off sharply and broadly as investors reassessed the durability of their business models in the face of rapid advances in AI. The main detractor here was ServiceNow. We reduced exposure to the stock in January and exited fully in early February due to rising competitive threats from AI. We also exited software holding Monday.com in January; these reductions in software-as-a-service companies benefited performance as the quarter unfolded and software stocks continued their decline. Risks of AI disruption were also behind our exits of social media platform Reddit and online travel services provider Booking. Negative sentiment in software also weighed on Microsoft. We have been reducing this position and now maintain an equal weight position as we further assess our software underweight.

### **Portfolio Positioning**

The Strategy entered the year overweight quality stocks in the industrials and materials sectors. While this detracted in the second half of 2025 due to the dominance of momentum stocks, we maintained our positioning as quality valuations became increasingly attractive. These overweights benefited us in the first two months of 2026 as cyclicals outperformed on improving industrial indicators. Regal Rexnord — an inexpensive early-cycle stock, in our view — benefited from both the improvement in ISM and from growth in its data center business, where it had previously been struggling to make meaningful inroads. Ferguson and Valmont also delivered positive results, helped by their data center supply chain exposure. Additionally, Deere benefited from improved demand for construction equipment.

Following strong performance in January and February and in response to the war in Iran, we reduced some cyclical exposure with trims to Trane Technologies, Clean Harbors, Deere and Flowserve. At the same time, we shifted to an overweight position in health care with the addition of Alnylam Pharmaceuticals, a biotechnology company with an attractive growth profile and the potential to become a drug discovery platform with differentiated RNA interference (RNAi) technology. RNAi is a relatively new class of drugs that prevent the body from producing specific disease-causing proteins. Alnylam expands our exposure to high-quality compounders delivering both strong returns and meaningful societal benefits.

We added three other positions, all in IT: ASM International, a semiconductor capital equipment company focused on deposition tools; Flex, an electronics manufacturing services provider with data

center power infrastructure exposure; and Enphase, a designer of microinverters for residential and commercial solar systems.

### **Outlook**

A key tenet of the Strategy's approach is that we aim to source most of our risk from stock-specific factors rather than macro factors. That said, the first quarter highlighted an increasingly complex macro backdrop marked by geopolitical tensions, rising energy prices and ongoing questions around returns of AI-driven investments. At the same time, underlying fundamentals remain resilient, indicators of industrial activity have improved, and we believe the portfolio is appropriately positioned with a predicted beta close to 1.0.

We favor physical assets and remain overweight industrials and materials, where we see compelling opportunities driven by secular tailwinds such as the buildout of data center and electricity infrastructure, U.S. reshoring trends and lower AI disruption risk. These sectors have also benefited from a shift in market leadership toward more cyclical and asset-heavy businesses. We are also overweight semiconductors. Across these sectors we favor stocks that benefit from the AI infrastructure buildout by supplying the "picks and shovels"; we seek ones that also trade at attractive multiples. We balance this exposure in light of macro uncertainty and concerns on hyperscaler AI capex with underweights to consumer discretionary and communication services.

We continue to build the portfolio from the bottom up, focusing on high-quality compounders with strong fundamentals, attractive valuations, solid balance sheets and capable management teams. In addition, the businesses we seek have favorable sustainability characteristics that further reinforce their fundamentals. In an environment where markets are increasingly rewarding quality and fundamental resilience (after shunning these factors in the second half of 2025), we believe these companies are well-positioned to outperform over the cycle.

### **Portfolio Highlights**

The ClearBridge Sustainability Leaders Strategy outperformed the benchmark Russell 3000 in the first quarter of 2026. On an absolute basis, the Strategy had positive contributions from six of 10 sectors (out of 11 total). The industrials and utilities sectors were the main positive contributors, while IT and financials were the main detractors.

In relative terms, overall stock selection helped while sector allocation detracted. Stock selection in health care, industrials and real estate proved beneficial, while stock selection in the IT sector detracted. In allocation, overweights to materials and industrials helped, while a lack of energy (oil and gas) holdings detracted significantly.

On an individual stock basis, the biggest relative contributors during the quarter were Johnson & Johnson, ASML, Equinix, Linde and US Foods. The biggest detractors were Exxon Mobil (not owned), ServiceNow, Microsoft, Danaher and AppLovin.

### **ESG Highlights: Materiality Drives Stewardship Insights**

ClearBridge's approach to ESG integration remains rooted in a simple but enduring principle: material environmental, social and governance factors are integral to long-term value creation. As the global sustainability landscape evolves amid shifting regulatory priorities, geopolitical complexity and rapid technological change, our approach continues to emphasize fundamental research, active ownership and a disciplined focus on materiality.

Our 2026 Stewardship Report highlights how this philosophy is translating into tangible outcomes, underscoring both the breadth of our engagement activity and the depth of our ESG integration across portfolios.

A defining feature of ClearBridge's ESG integration is our proprietary ClearBridge Materiality Framework™, which identifies the ESG factors most relevant to each sector and subsector. Engagement priorities are derived from this framework at the company level, ensuring that these efforts focus on issues that are financially material and aligned with our fiduciary duty.

In 2025, several key themes emerged as focal points of engagement:

- Decarbonization and climate adaptation
- Critical minerals and human rights
- Biodiversity and natural resource management
- Responsible AI and data governance
- Governance and shareholder rights

These themes reflect both structural global trends and evolving investor priorities. For example, climate-related engagements increasingly addressed not only emissions reduction but also adaptation and resilience topics, such as grid modernization, water management and disaster preparedness. Companies like DTE Energy, a utility making grid modernization and storm hardening investments, and Eaton, which builds backup power and electrical resilience systems, illustrate how investments in infrastructure resilience can support both sustainability outcomes and long-term earnings durability.

Similarly, the energy transition has elevated the importance of critical minerals, where demand for copper, lithium and rare earths is driven by electrification, AI infrastructure and renewable energy deployment. ClearBridge engagements in this area extend beyond environmental impact to include human rights, supply chain practices and community relations, particularly through collaborative initiatives such as PRI

Advance, with which we have engaged with mining companies Antofagasta and Freeport-McMoRan.

The integration of new teams across regions in 2025 further strengthened the ClearBridge Materiality Framework™ by incorporating new insights from emerging markets, the U.K. and Australia. This global perspective enhances our ability to identify best practices, anticipate risks and engage companies more effectively across diverse regulatory and operating environments.

#### Insights from Global Engagements

ClearBridge's global engagement activity provides a number of practical examples of how ESG considerations translate into investment insights and outcomes. Across regions, the most frequently addressed ESG factors in 2025 included energy transition risks, environmental impacts of operations, community relations, employee health and safety, capital allocation and executive compensation.

Several engagements illustrate our pragmatic approach focused on long-term value creation and positive change:

- **Amazon.com (U.S.):** Engagements focused on labor practices, safety and environmental efficiency. As of the first quarter of 2025, the company reported a 65% reduction in lost-time injuries over the last five years, progress toward net-zero by 2040 and improvements in logistics efficiency and renewable energy use. These developments demonstrate how operational improvements can enhance both social outcomes and cost efficiency at scale.
- **ASML (Netherlands):** Discussions centered on water usage, energy efficiency and supply chain emissions. While direct water usage is limited, engagement highlighted increasing regulatory and regional risks — water is a material topic due to increasing regulatory scrutiny, particularly in the Netherlands, and in Taiwan and the U.S. water stress is now considered a medium-level risk — reinforcing the importance of forward-looking risk management even where current exposure appears modest.
- **Walmart (U.S.):** Engagement emphasized workforce development, wages and human rights in the supply chain. The company's focus on internal upskilling and technology-enabled human rights monitoring illustrates how social considerations can strengthen operational resilience and labor productivity.
- **Toronto-Dominion Bank (Canada):** We engaged the company against the backdrop of U.S. regulatory scrutiny tied to material deficiencies in TD's anti-money laundering (AML) program and proxy advisor recommendations to withhold votes from board members. ClearBridge's nuanced voting decision in favor of contested directors took into account a meaningful board refresh in 2025 and momentum in remediation; it also reflected insights gained through direct dialogue, highlighting the value of active ownership beyond standardized proxy recommendations.

- **Freeport-McMoRan (U.S.):** Engagement on emissions, water management and human rights demonstrated the complexity of balancing environmental performance with operational realities in resource-intensive industries. Progress on emissions reduction initiatives and disclosure improvements supported continued investment conviction while identifying areas for further engagement.
- **Companhia Paranaense de Energia (Brazil):** Engagements centered on governance transformation following privatization. Improvements in board independence, disclosure practices and strategic focus highlight how governance reform can unlock value and improve investor confidence in emerging markets.
- **MercadoLibre (Latin America):** Engagement on data privacy and cybersecurity led to improved disclosures and attainment of ISO 27001 certification — an independent, third-party audit confirming an organization’s information security system manages data security risks effectively. This progression highlights how governance and technology-related ESG factors are increasingly central to maintaining customer trust and supporting growth in digital platforms.

#### Responsible AI and Emerging ESG Themes

One of the most rapidly evolving areas of ESG analysis in 2025 was responsible AI. As AI adoption accelerates across industries, factors such as data privacy, ethical use of AI, labor implications and environmental impacts such as energy and water consumption from data centers have grown in importance in our analysis.

This reflects the increasing importance of technology-driven risks and opportunities in sustainability analysis. Responsible AI is now viewed as a material factor influencing competitive positioning, regulatory exposure and stakeholder trust. ClearBridge’s approach emphasizes balancing innovation with accountability, seeking to ensure that companies adopt AI in ways that are transparent, secure and aligned with long-term societal value.

#### Conclusion

The 2026 Stewardship Report highlights a year of continued progress for ClearBridge’s ESG platform, characterized by global engagement activity and deeper integration of material sustainability factors into investment decision making. As global markets continue to evolve, our approach positions us to navigate complexity while identifying opportunities that align sustainability with shareholder value.

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